DOW THEORY LETTERS INC.

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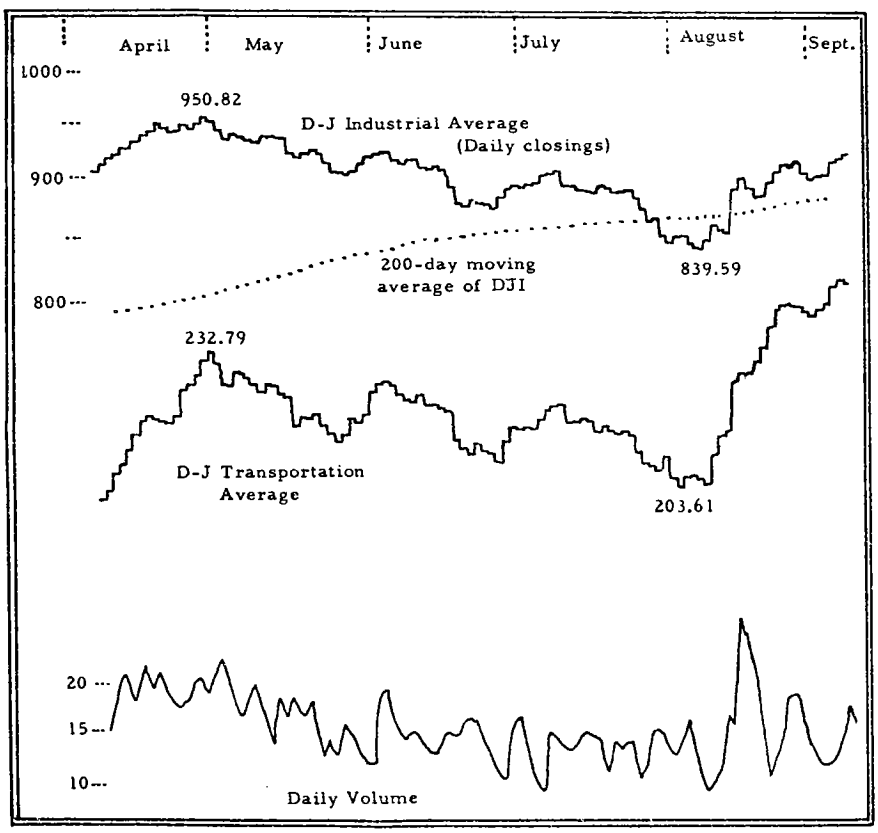
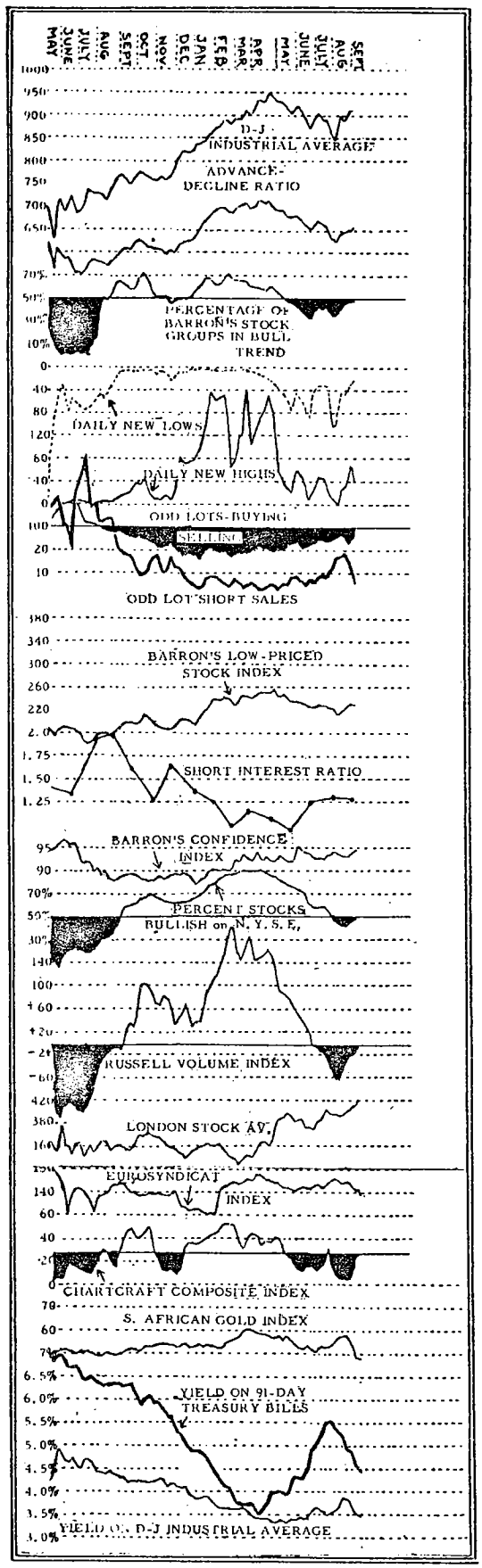
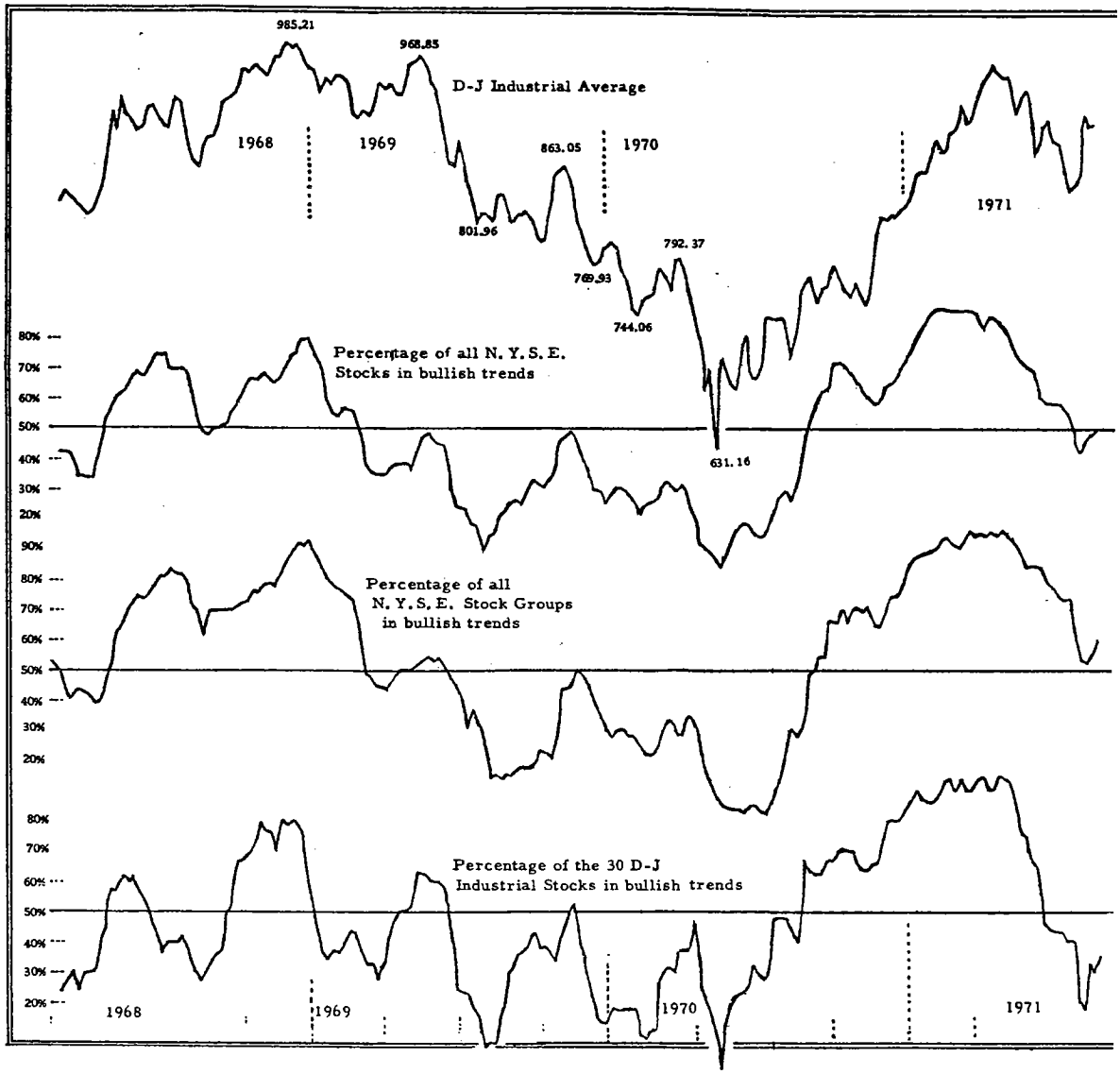
FAMOUS FORGOTTEN WORDS DEPT.: President Nixon, February, 1971: "Free prices and wages are the heart of our economic system; we should not stop them from working even to cure inflationary fever. I do not intend to impose wage and price controls which would substitute new, growing and more vicious problems for the problems of inflation."

THE MARKET: Last week I spoke to two leading executives in stock exchange firms, one on the East Coast and one in the West. What they told me was essentially the same. The brokerage business "is drying up", the customer of three or four years ago has disappeared, the public is growing increasingly apathetic, and the only real "action" is from the institutions and funds. Here, as one of these gentlemen put it, one finds "the funds selling blocks to each other", and rushing headlong into one stock while rushing with just as much speed out of another. This makes for violent, compressed moves in a few issues, while the mass of issues float lackadaisically back and forth on the waters of disinterest.

My intuition checks with the findings of the Holt Investment Advisory which noted (Sept. 3 report) that seasonally adjusted sales of corporate and mutual fund shares by private individuals (odd and even lots) during 1970 amounted to a $2.6 billion rate. During the first half of 1971 the selling rate jumped to $8 billion. The current selling rate is running at a whopping $10 billion! "Such a massive rate of public liquidation cannot possibly continue very long without causing a general market decline. Sooner or later, it will overwhelm demand from other investing groups." Concludes Holt, "The risk of a drastic market decline is greater now than any time in this generation."





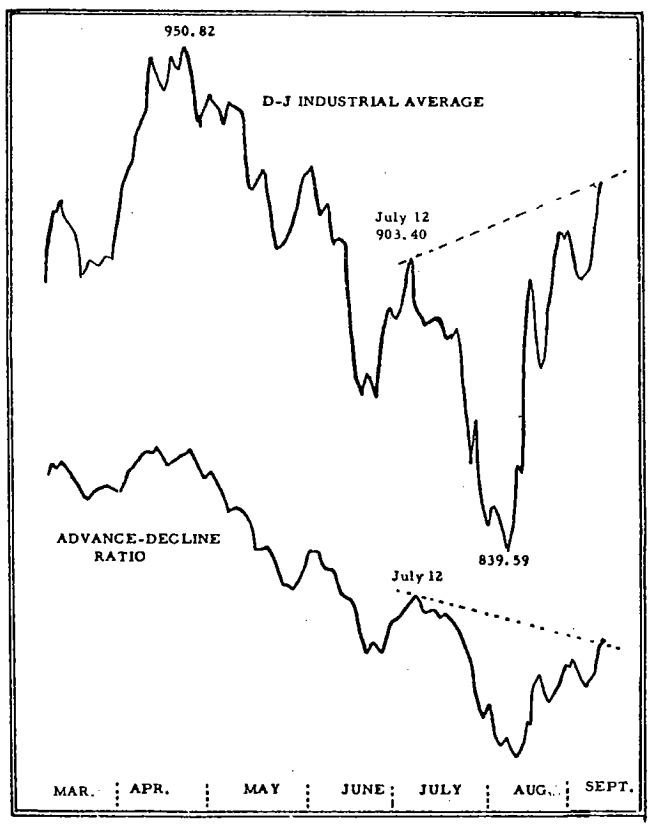


I am including my "Bullish Percentage" chart. This chart shows the Dow superimposed upon three indices, (1) the percentage of all stocks on the N. Y. S. E. which are in bullish trend, (2) the percentage of all N. Y. S. E. groups in bullish trend, and (3) the percentage of the 30 Dow Industrial stocks in bullish trends. (These statistics are from Chartcraft's weekly tabulations).

What I have been noticing is that the April to August, 1971, decline took two of the three bullish percentage indicators below the critical 50% level into bearish territory. The lows of August saw the Dow Industrials at 839.59, with 42% of all stocks bullish and 13% of the 30 Dow Industrials bullish. The group bullish percentage succeeded in holding above the 50% level. By last week, with the Dow above 900, 50% of all stocks were bullish and only 37% of the 30 Dow Industrials were bullish.

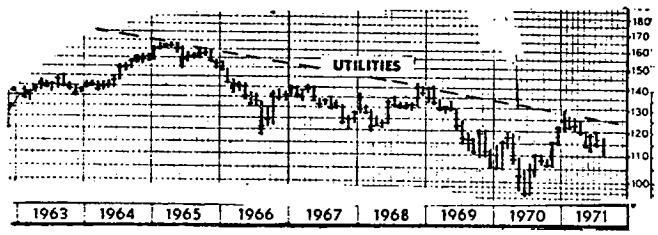
Thus it seems to me that the rise now in progress is most selective, having started from a far-from-oversold position or anything comparable to the massive oversold of mid-1970.

In the last Letter I noted that the new recovery highs in the Transports have, so far, been unconfirmed by Industrials (a confirmation by Industrials would entail a bettering of the April peak of 950.82). At the same time, the Industrial bettering of the July 12 peak of 903.40

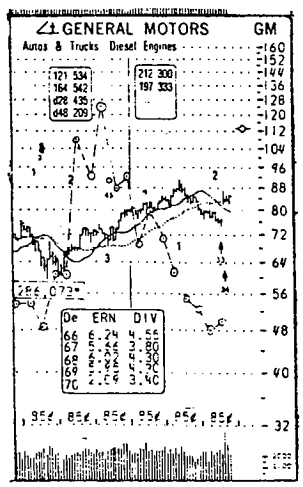


has not been confirmed by the advance-decline ratio. Thus we have a series of technical non-confirmations at present, and it will be most interesting to see whether the Industrials will have the strength to better their April (950.82) peak, and whether the A-D ratio will have the strength to hurdle its July peak. In order to provide readers with a clearer picture of the current technical picture, I have included (page 2) an up-dated chart of the Dow and the A-D ratio. The non-confirmation in Industrials and Transports can be seen clearly on the lower page 1 chart.

Frankly, I have never before seen this triple non-confirmation series in Industrials, Transports and the A-D ratio, and I therefore am most interested in seeing how the picture will materialize. Obviously, it will require a persistent and broadening advance from here to clear the technical air.



Meanwhile, a few of the other indicators which I follow are stamping out bearish signals. For instance, on August 31 the D-J Utility Average (this must have been the best kept secret of the year) broke to a new 1971 low. Over the years the Utility Average has produced a good record of being a harbinger of things to come, and a trend to new lows (particularly during the latter half of the year) in this Average has never been a happy occurrence. I include a Monthly chart of the Utilities going back to 1963, and here we can see how the downtrend of 1965 foreshadowed the smash of 1966, and how the virtual sideways movement of 1967-68 presaged the collapse of 1969-70. Now with Utilities breaking to lows for the year during late-August and September, I would think that they were saying that the general market atmosphere is growing ripe for the bear market to reassert its power later this year or during early-1972.



A second indicator well worth watching is General Motors. Letter 501 drew attention to the downside breaking of all trends by GM, and I stated that when the world's greatest manufacturing enterprise looks this bad on a trend basis, watch out. I might also repeat the old market adage (which has proved remarkably accurate) that when four months elapse without a new high in GM, it is prudent to conclude that the trend of the general market is down.

Note the weekly chart from Quote Digest (P.O.Box 213, Wichita, Kans. 67201). Here we see the high for the year registered on April 29 at 91 1/8. The stock got down as low as 74 7/8 on the April-August decline, and then Mr. Nixon announced his 10% import surcharge and a removal of the auto excise tax. GM leaped up to 87 1/8, but this was not above the April 29 peak. Since the 87 1/8 August high, GM has been drifting lower. It is now longer than four months, and no new high on GM. Thus the bearish rule for the market is in effect. Note: The beaded, dashed-line on the chart is the trend of the short interest in GM. The fine dotted line is GM's 200-day moving average.

THE FUNDS: I believe that it is important for subscribers to understand just what is occurring in the $50 billion mutual fund industry. In July it was reported that mutual funds were subject to more redemptions than purchases, a net outflow for the third month in a row. This is an unprecedented situation not seen in the 30-year record of the industry.

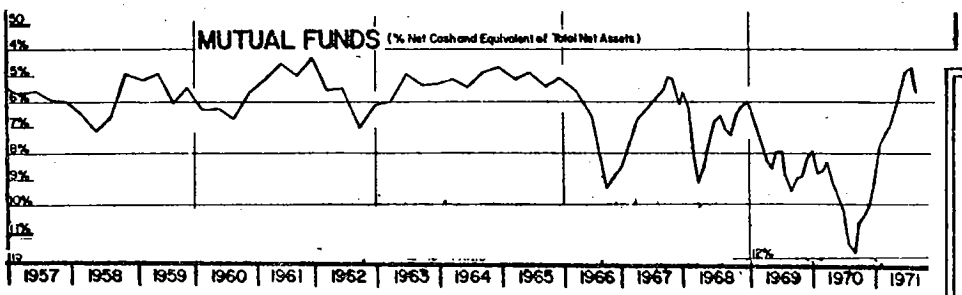
I have borrowed figures (page 4) from the Consensus of Insiders report, showing just how the breakdown in fund transactions works. Note that in May funds spent $349 million of their own cash to buy stocks, even though there were $121 million more redemptions than purchases of funds. The net result in May was that funds did purchase $317 million of stocks. I have also drawn a chart which traces the net flow of fund money as shown by the figures. As readers know, I always prefer charts as convenient vehicles to dramatize the figures.

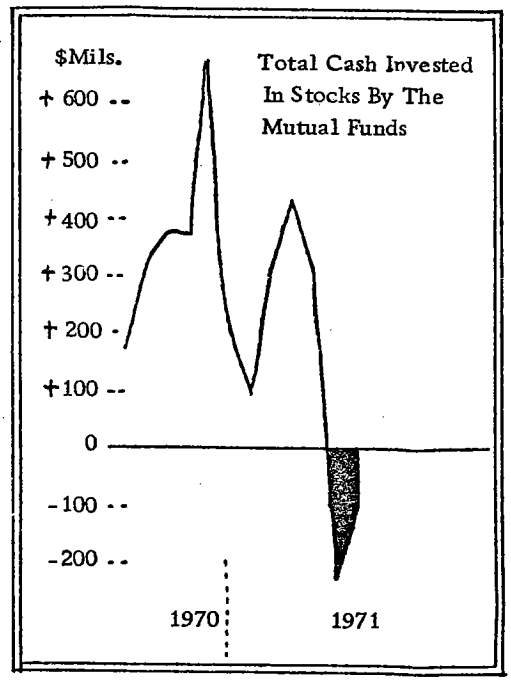
In June redemptions continued to surpass purchases in the world of funds, but that same month the funds reduced their holdings of stocks by $223 million. Thus the sales of stock plus a drop of $32 million in net new money (or redemptions over sales) resulted in the funds actually selling $255 million in stock. This was different from May in which the funds ended up buying stocks.

In July the funds sold $26 million in stock and they lost $72 million in redemptions over purchases, meaning that they sold a total of $98 million in stocks on the market. At the end of May the mutual fund industry has only 4.9% of its total assets in cash, a very miniscule amount as you can see from the accompanying chart on page 4 (chart courtesy of Paflibe Chartbook, 18 E. 41st St., N.Y.C. 10017). By the end of July the percentage cash had risen to 5.6%, which was still nothing to brag about.

NET STOCK INVESTMENTS BY ALL MUTUAL FUNDS (add ,000)

1970 - 1971	From CASH	From "new money"	Total Invested
AUGUST	$ 22,849	$ 144,393	$ 167,242
SEPTEMBER	200,505	139,421	339,926
OCTOBER	216,975	177,468	394 443
NOVEMBER	250,611	128,506	379,117
DECEMBER	477,213	159,079	636,292
JANUARY	-13,705	244.978	231,273
FEBRUARY	62,345	26.212	88,557
MARCH	272 710	43,648	316,358
APRIL	281,636	153,593	435,229
MAY	439,288	-121,481	317,807
JUNE	-223,426	-32,421	-255,847
JULY	-26,152	-72,310	-98,462
12 Months	$1,960,849	$ 991,086	$2,951,935





Conclusion: Over the past two months the mutual funds have been responsible for unloading $350 million of stock on the market. If the public continues to sell their funds, I expect steady and even rising pressure from the funds on the market. As the bear market goes into its final phase, the redemptions should become torrent. That torrent will help drive the Averages to extraordinary lows, well below the lows of 1970.

GOLD AND POWER: I have drawn two charts (page 5) which go a long way in illustrating what has happened to gold and world monetary assets since the mid-1940's (or around the time when World War II ended). Actually, the end of World War II found the U.S. at the height of its power relative to other nations. The U.S. had not been bombed or ravaged, its factories were intact, its productive capacity huge, its scientific and industrial know-how unchallenged.

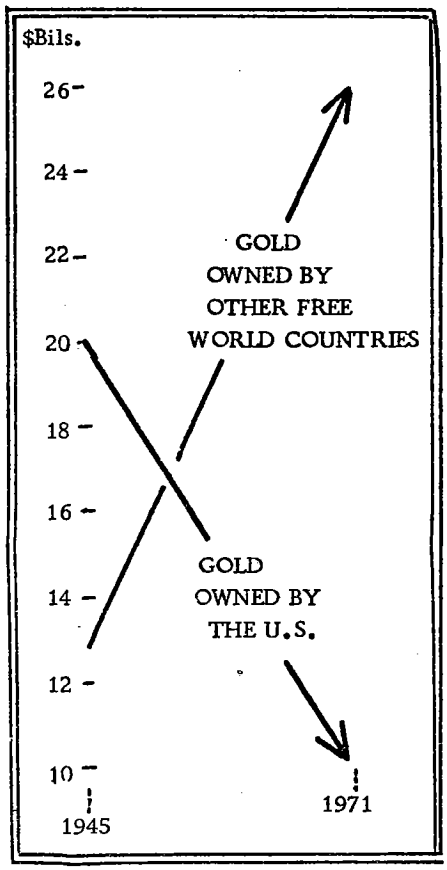
I am using the movement of gold as a barometer of power, and I am again repeating the old adage, "Gold goes to the strong". The first chart, in view of this, is rather self-explanatory. During the quarter century since 1945, the U.S. has lost over half of its gold reserves, while the rest of the world has roughly doubled its gold reserves. In fact, West Germany, France and Italy now possess about $10.5 billions in gold, which is more than the current U.S. hoard of about $9.5 billions. In addition, Switzerland owns $2.8 billion, Holland $1.9 billion and Belgium owns $1.6 billion. It is clear, then, that the Free World has a large vested interest in gold, and the price of gold affects their reserves vitally.

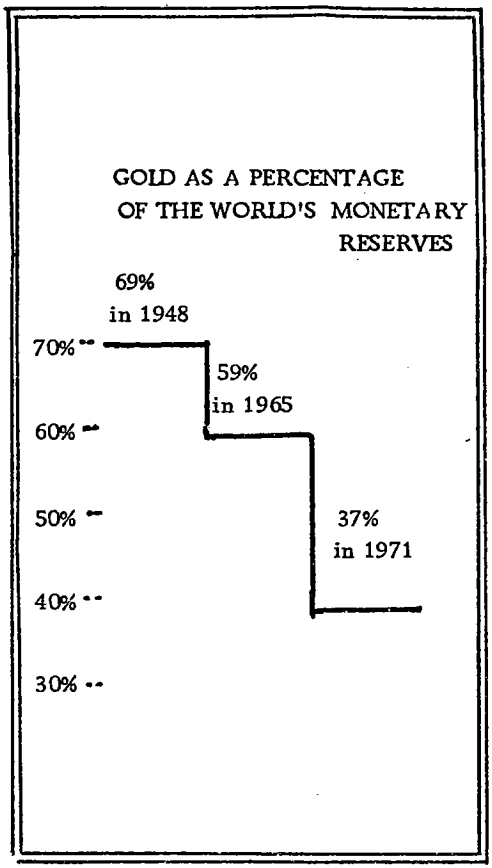
The second chart illustrates what part gold plays in the total world monetary reserve picture. In 1948 Gold constituted 69% of world monetary reserves, which meant that world reserves were literally gold-backed. By 1971 gold had dropped to 37% of world monetary reserves, and it can be seen that roughly two-thirds of the current world's reserves are now in paper. Paper, I might add, is only as good as the confidence behind it. With gold, no one needs confidence in a nation's intent or its ability. The confidence resides in the gold itself. The U.S.'s creditors (who have just faced our gold embargo) are only too painfully aware of that fact.

It is interesting to note that if the price of gold were doubled to $70 per ounce, the percentage of gold in the world monetary reserve picture would jump to about what it was in 1948. At the same time, the Free World nations other than the U.S. (who now holds most of the gold) would be happy, and the U.S., if nothing else, would be thrust a little closer to reality. Will it happen? I think in time it will, and already it is clear that this is what Europe most wants. Undoubtedly the IMF meeting in mid-September will raise the gold re-pricing question, and the U.S. will just as surely object. But it is notable that not a single European nation (nor has Japan) revalued its currency. They have simply floated their currencies, which is a nebulous,

holding action, a "teaser" preparatory to the main game. I feel certain that Europe and Japan will want a dollar devaluation and an early removal of the 10% surcharge in return for revalued currencies.

Meanwhile, the U.S. position is feebler than at any time since World War II, and the main resistance to a raise in the gold price is simply face-saving (Nixon does not want to go down in the history books as the President who presided over an official dollar devaluation). Nevertheless, if Europeans reprice gold on their own Nixon could go along with it, and perhaps even save face by pulling out all the old saws such as "We blame the international monetary speculators," and "It's the fault of the Zurich Gnomes," etc., ad nauseum.





All during 1971 I wrote that a gold embargo or outright devaluation was in the cards before the end of the year. The story was in the figures, and anybody who took the trouble to study them would probably have agreed with me. Now I say that these two charts indicate that Europe will not be happy with anything less than a large dollar devaluation.

The reasons are obvious. Europe has a large stake in gold; she has a hoard more than twice as large as that of the U.S. Second, the U.S. has been passing out dollar IOU's (payable in gold) while buying up the Free World's assets. The U.S. now owns over $160 billions of overseas assets, assets bringing in almost $10 billion a year. But suddenly, Uncle Sam renigged on its IOU's. The Free World is stuck with billions in U.S. printing press paper.

The problem is — what to do with the mountain of U.S. fiat paper? From Europe's standpoint, the best thing would be to double or triple the price of gold, make the dollar convertible again, revalue all currencies, and hope that the U.S. can come to its senses regarding inflation and productivity. Barring such a solution, the Free World will be sitting with the biggest pile of non-redeemable IOU's since the dawn of creation, and the U.S. will have pulled off the biggest and most immoral economic coup since the settlers bought Manhattan Island from the Indians for $24 worth of colored beads.

Remember, raising the gold price will not be the whole answer. For the trends which moved gold from the U.S. to Europe are economic trends, and they are continuing (surcharge or no surcharge) even while you are reading this report.

NOTE: I'll give you an example. My wife is doing very important psychological work which requires videotaping. After inspecting the market for non-broadcast videotape, I realized that this seedling industry is almost completely in the hands of the Japanese, with Sony the leader. Sony is making 1/2" videotape machines which sell for around $1000 with camera and recorder. Now Akai (another Japanese firm) has come out with the first 1/4" video set-up to sell near the Sony range, and the tape is much cheaper. For instance, an hour of taped pictures and sound cost about $15 on the Akai compared with perhaps $160 and up for super-8 sound film and vastly more for 16mm sound film! My conclusion: The Japanese are shortly going to make vast inroads in the huge, home amateur and semi-professional movie industry. And videotape is going to cut tremendously into film. And it's going to be a Japanese industry, almost all Japanese (except for a few U.S. outfits such as Ampex). Suggestion to all subscribers connected with distribution of photo supplies ..... look into the new Akai 1/4" video machines immediately. If you can get a franchise, grab it.

Schultz Scoop: After writing this section, I received the latest Harry Schultz Letter and friend Harry (Dr. Schultz to you and me) has come through with a blockbuster which he says comes from reliable sources. Schultz states that against the roughly

$10 billion in gold left in the U.S., there are U.S. Government bonds payable in gold to the tune of around $5 billion to Germany, $2 billion to Switzerland. If true, this would mean about $3 billion in gold in the U.S. No wonder, exclaims Schultz, the U.S. embargoes gold! All of which has my head spinning.

NOTES: Whenever a nation attempts to solve fundamental problems via the manipulation and controls road, you can be sure that the manipulations and controls will produce more questions than solutions. That is my feeling regarding the new "Nixonomics", and already the questions are cropping up by the dozens. "What happens to the freeze after the 90 days?" seems to be the number one question. Second seems to be, "With labor screaming 'Unfair', will Nixon try to impose an excess-profits tax as a quieter for labor?" I could go on and on listing questions, but space prohibits.

I will provide one "answer" however. That is that whatever happens, the American public will pay for it either in new taxes or in greater debt. I include this squib from the September Changing Times magazine, and I think it is worth studying.

Note that national defense and interest on the national debt (the interest is largely on defense items purchased during war and peace) comes to a combined $1,342 per family. This means that of the $3,165 ($245 above last year!) that each family pays annually for taxes, 42% stems from war or peace-time defense. I submit that this trend will ultimately "eat up" or break the nation.

Where your federal taxes are going. Divide the total take of the federal government from income, social security, excise and other taxes that consumers pay by the number of households in the country and you'll find the average household federal tax burden will be $3,165 for the current fiscal year. That's the Tax Foundation's estimate, and it figures the load is $245 heavier than it was a year ago. Here's how some of the spending for major categories breaks down per household:

national defense	$1,070
health & welfare	1,060
interest on national debt	272
commerce & transportation	151
veterans	147
education & manpower training	122
agriculture	80
community development & housing	62
natural resources	59
international	56
space	44

One of the problems Mr. Nixon is going to have to face shortly is the conservative wing of the Republican Party opting for new and higher defense spending. The ICBM count is on again, and it is pointed out that Russia is ahead of us. Personally, I am not impressed. I have said repeatedly that I think the big war coming up is going to be on the economic front, and here we might watch Japan as she opens up Russia and China to increasing trade, and pushes for bigger inroads into a frightened Europe. As Eliot Janeway just wrote, "Japan has been running scared of an American Depression," and this is the reason she is willing to talk limitations on volume of sales here. But in the meantime, Japan is intent on moving into as many other world markets as she can, and my bet is that the Japanese are going to be increasingly successful. The Japanese represent the roughest competition in the world today from the standpoint of price, quality and ingenuity. And they don't mean to slow down.

The gold and silver chart (weekly) is shown below. Gold is holding well, though Harry Schultz claims that there is a well-organized plot going on to drive the price of gold down, so that "certain very highly placed political figures and certain North American bullion dealers can buy gold on the cheap," prior to a re-pricing. Could be. The price of silver has sunk to a 4-year low, and the bear market in silver is obviously still on. Before silver hits bottom, it seems fated to wipe out every silver speculator from here to Hong Kong.

SIGN OF THE TIMES: Heads rolled on the N.Y. police force in the biggest shake-up in 20 years as Commissioner Pat Murphy fired, replaced and transferred men (from top echelons down) across the face of the city. The problem is narcotics, and the fact that police participation in drugs is now so flagrant and widespread that it can no longer be ignored. Thus the "guardians of the law" are immersed in the lowest of all the rackets, hard drugs. I don't know why I'm writing this except that it reminds me of the famous line about the Nazi concentration camps: "The horror was that nobody (in Germany) was horrified." In New York the shocker is that no one is shocked. Hypocrisy, it seems, is king in the U.S. during the early 1970's.